

Box 3

THE EU-MERCOSUR TRADE AGREEMENT AND ITS IMPACT ON THE EUROPEAN ECONOMIES

At the end of June, the European Union (EU) and the four Latin American countries which make up the MERCOSUR trading bloc (Argentina, Brazil, Paraguay and Uruguay) signed a historic trade agreement after 20 years of negotiations. The treaty – pending final wording and ratification¹ – envisages the removal of tariffs on more than 90% of the trade in goods between the two areas and includes provisions which facilitate trade in services and the liberalisation of public procurement processes. Given its broad scope, the agreement is expected to notably boost bilateral trade and economic integration between the two regions. The treaty is also a sign of the EU's commitment to maintaining free trade against a global setting of growing protectionist tensions. This box describes the main features of the agreement and discusses its scope from a sectoral standpoint.

Under the agreement, the MERCOSUR countries will remove the tariffs on 91% of the goods imported from the EU, which include key EU exports such as vehicles and machinery. In turn, the EU will liberalise 95% of the goods imported from MERCOSUR, including 82% of imports of agricultural products. Certain products such as meat and sugar, will be subject to a partial liberalisation. In general, tariffs will be reduced over a 10-year period from the ratification of the agreement. The agreement also includes some provisions, which reduce non-tariff barriers by simplifying customs procedures, and others, which facilitate trade in services through non-discrimination clauses against foreign companies. Likewise, the treaty envisages the liberalisation of public procurement processes by both parties. Thus, European firms will be the first non-MERCOSUR firms to have access to these processes on an equal footing with local firms; to date they could only participate through their subsidiaries.² In line with the model of trade agreements imposed in recent years, the treaty also includes provisions for safeguarding the environment and labour standards, such as employees'

freedom of association, the right to collective bargaining and non-discrimination at work.

After China, the EU is currently MERCOSUR's second most important trading partner and represents 20% of goods trade with the Latin American bloc. Trade with MERCOSUR only represents 2.2% of the EU's trade in goods and services.³ Following the usual pattern in trade between developed and emerging economies, the EU has a comparative advantage over MERCOSUR (Chart 1.3) in the supply of higher technology content products, such as machinery, electrical products or chemicals, whereas the comparative advantage of the MERCOSUR countries lies in raw material or natural resource intensive goods such as livestock, minerals, food and crop products. That is reflected in the bilateral trade patterns between the two areas shown in Charts 1.1 and 1.2, together with current tariff levels on the different product types. As can be seen, whereas the Latin American bloc's imports to the EU are concentrated in agricultural and food products, European exports to MERCOSUR mainly comprise chemicals, pharmaceuticals, machinery, vehicles and electrical products which are currently subject to high tariffs. Although services are not shown in the chart, the EU is a net supplier of all types of services.

The agreement is notably important for the EU in view of MERCOSUR's high tariff barriers in key areas of bilateral trade. The size of the trade flows affected by the MERCOSUR treaty is similar to or slightly lower than that covered by the recent treaties entered into with Canada and Japan. However, in comparison with the latter, the MERCOSUR treaty will entail a much higher reduction in export costs since the decrease in tariffs under this agreement will be comparatively sharper for Europe's main exports, according to European Commission estimates.⁴ In terms of the agreement's effect on EU activity, certain available studies indicate that its long-term positive impact on activity is estimated to be between 0.1% and 0.3% of GDP.⁵

1 The agreement must be approved by the European Parliament and probably - based on the provisions included in the final text - it must also be approved by the national parliaments of the states involved. (<https://ec.europa.eu/trade/policy/in-focus/eu-mercosur-association-agreement/agreement-explained/>).

2 Firms based in the Latin American bloc and controlled by a European parent company.

3 Europe's trade balance with the Latin American bloc has shown a slight surplus over recent years (+0.02% of GDP in trade in goods in 2018 and +0.08% in trade in services in 2017).

4 The European Commission calculates that the MERCOSUR agreement would save around €4 billion in terms of lower tariffs. This saving was estimated to be lower or equal to €1 billion for the agreements with Canada and Japan.

5 C. Kirkpatrick, and C. George (2009). "Trade sustainability impact assessment (SIA) of the association agreement under negotiation between the European Community and MERCOSUR". Institute for Development Policy and Management, University of Manchester and A. Burrell, et al. (2011) "Potential EU-MERCOSUR free trade agreement: impact assessment." Publications Office of the European Union.

THE EU-MERCOSUR TRADE AGREEMENT AND ITS IMPACT ON THE EUROPEAN ECONOMIES (cont'd)

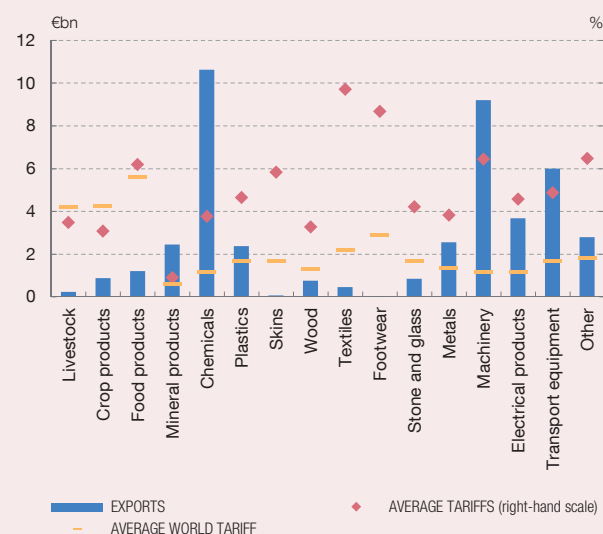
Chart 2.1 shows the EU economies which, in principle, could benefit most from the removal of the tariffs since they specialise in production in the sectors with a comparative advantage over MERCOSUR. Furthermore, they will stand to gain from substantial tariff cuts. Noteworthy among these countries are those specialising

in chemicals, transport, machinery and electrical products. Additionally, European countries which are relatively more specialised in providing services could enjoy new growth opportunities in these markets (Chart 2.2).⁶

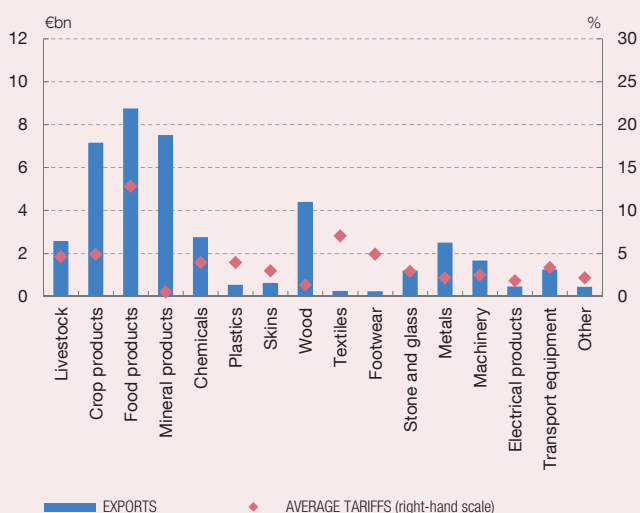
The MERCOSUR countries have, as mentioned, an advantage in the production of food, agricultural products

Chart 1
CURRENT TRADE RELATIONS BETWEEN THE EU AND MERCOSUR

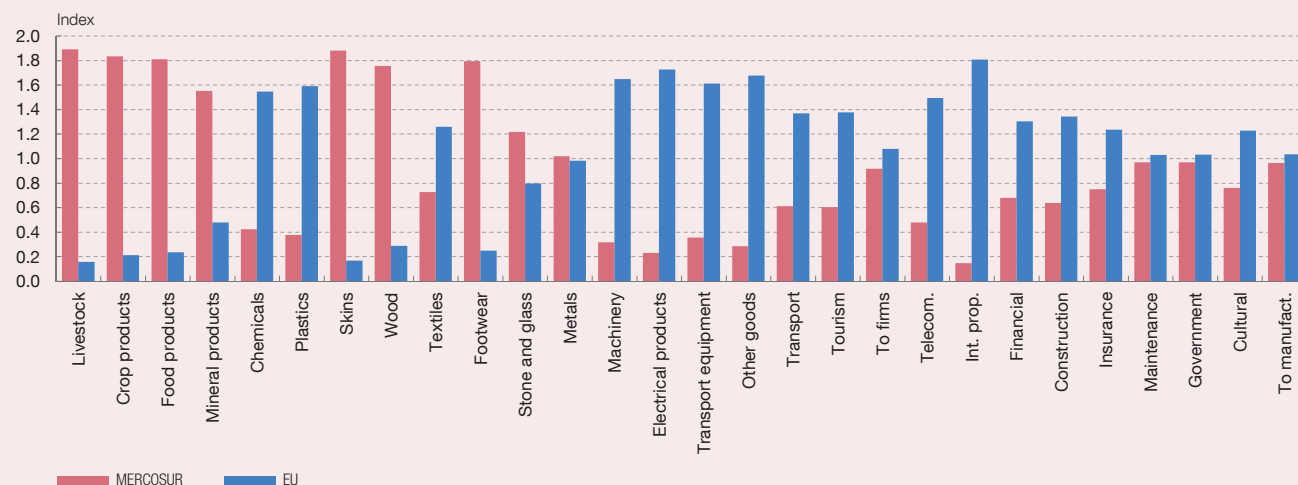
1 GOODS TRADE: EU EXPORTS TO MERCOSUR AND AVERAGE TARIFFS



2 GOODS TRADE: MERCOSUR EXPORTS TO THE EU AND AVERAGE TARIFFS



3 COMPARATIVE ADVANTAGE INDEX



SOURCES: Eurostat, WTO, World Bank and Banco de España calculations.

⁶ The analysis does not include tourism services, on which the agreement would have a low impact, or intellectual property rights, since the classification of the TIVA database does not quantify their weight in GDP.

THE EU-MERCOSUR TRADE AGREEMENT AND ITS IMPACT ON THE EUROPEAN ECONOMIES (cont'd)

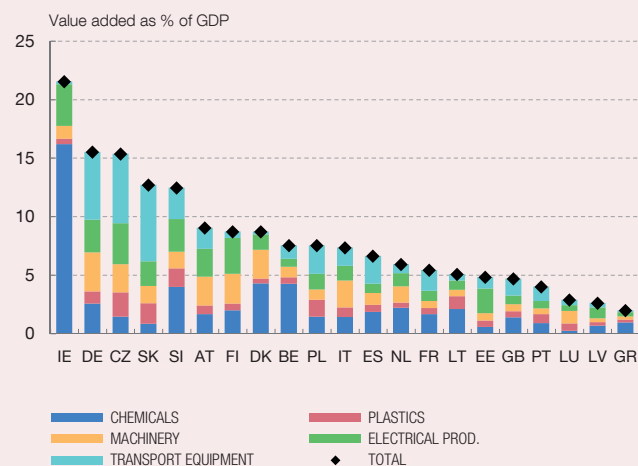
and minerals. Chart 2.3 shows, for the main European economies, the weight in GDP of sectors in which MERCOSUR has a comparative advantage, based on those sectors' value added share in terms of EU final demand. The countries most exposed to competition from MERCOSUR would be those where the agricultural and food sectors have the highest weight, along with France, since beef production is considered to be a

branch of the agricultural industry in which the Latin American bloc has a particularly high comparative advantage.

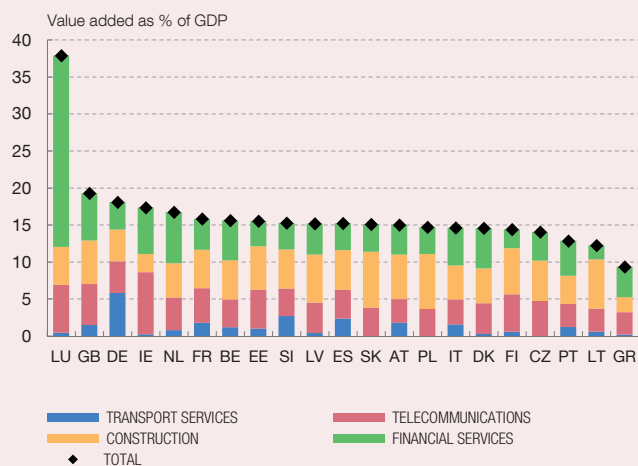
However, the analysis performed solely on the basis of the comparative advantages shown underestimates the opportunities offered by the agreement in currently highly protected sectors in Latin America, such as textiles and footwear, which relatively specialised European economies

Chart 2
COMPARATIVE ADVANTAGE OF THE TWO BLOCKS. COUNTRIES MOST FAVOURED BY THE AGREEMENT AND ECONOMIES MOST EXPOSED TO COMPETITION FROM MERCOSUR

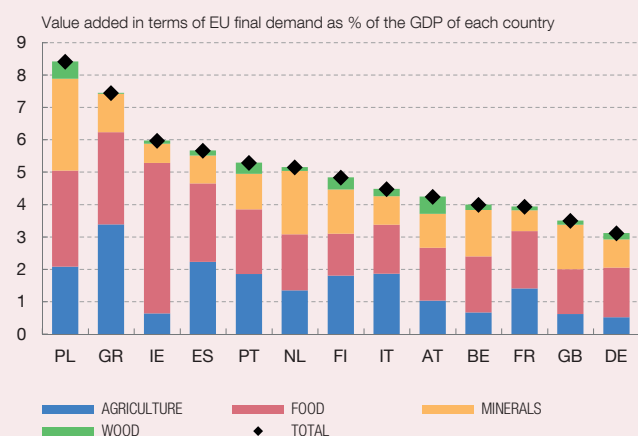
1 GOODS: SIGNIFICANCE OF THE SECTORS IN WHICH THE EU HAS A COMPARATIVE ADVANTAGE



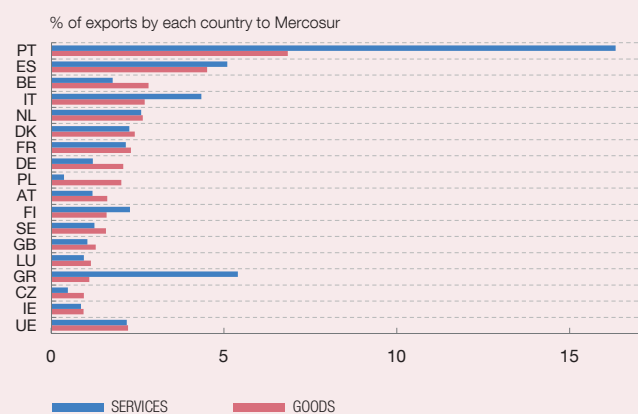
2 SERVICES: SIGNIFICANCE OF THE SECTORS IN WHICH THE EU HAS A COMPARATIVE ADVANTAGE (a)



3 EXPOSURE TO COMPETITION FROM MERCOSUR



4 SIGNIFICANCE OF TRADE WITH MERCOSUR



SOURCES: Eurostat, Comtrade, OECD TiVA, IMF and Banco de España calculations.

a For Poland, the Czech Republic and Slovakia, we omit the value added provided by road transport services, which foreseeably will not benefit from the agreement.

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such as Portugal, Italy and Spain⁷ could benefit from. In addition, the analysis does not take into account the potential advantages of this agreement for countries such as Spain and Portugal, based on other driving factors of trade such as cultural and linguistic ties.⁸ In fact, goods and services trade with the Latin American bloc represents 4.5% of Spain's trade, which is double the EU average, a characteristic it shares with Portugal, the other EU country to have a language in common with a MERCOSUR

economy (Chart 2.4). Furthermore, of the European countries, Spain is currently the second most important service provider to the Latin American bloc. This puts Spain in a privileged position for taking advantage of the opportunities of this agreement, both commercially and as regards the provision of services and the participation in public procurement, although certain raw-material intensive sectors will experience greater competitive pressure.

7 The value added by these industries as a percentage of GDP is 2.6% in Portugal, 1.9% in Italy and 0.7% in Spain.

8 The literature supports the influence of these factors when explaining bilateral trade flows. See, for example, Bayer et al. (2007), "Free trade agreements in the Americas: are the trade effects larger than anticipated?" *The World Economy*.